

EXECUTIVE SECRETARIAT
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Remarks

Executive Secretary

28 Jul 86

Date

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Washington, D.C. 20505

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| Executive Registry |
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28 July 1986

The Honorable Bill Bradley
United States Senate
Washington, D. C. 20510

Dear Bill,

I want to congratulate you on your contribution to simplifying our tax structure. I used to practice tax law and have written more books on tax matters than I care to think about. I recall a speech I made somewhere in the late 1950s or early 1960s before the Tax Institute in Princeton. I said that if we got rid of the complexities and rate differentials in our tax code it would redirect enough ingenuity to achieve the conquest of space in a decade. You've taken a long step in that direction.

I would also like to commend your initiative on the Third World debt situation. I think you'll find interesting a little paper I did on this subject a while ago and I enclose it.

Yours,


William J. Casey

Enclosure:
14 February 1986 paper,
"The Debt Crisis: The Need
for Innovative Action"

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14 February 1986

The Debt Crisis: The Need for Innovative Action

The Third World debt problem has become more intractable over the past three years, and we believe that no feasible combination of debtor country actions, new loans, interest rates, commodity prices, or economic growth will be sufficient to solve the problem. Indeed, the situation resembles that of Imperial Germany after its defeat in World War I when unpayable war reparations--even when stretched out under various repayment schemes--led to a steady increase in Germany's international debt which had eventual political repercussions that shook the entire world. Today, we believe that the situation is equally dangerous and perhaps more so because the debtor-creditor crosswebbing covers the entire globe.

In looking at this financial quagmire, one fact is clear--the debt is so large it cannot be repaid. Indeed, despite rescheduling and efforts at belt-tightening, the debt burden has worsened since 1982.

- o Third World countries have to borrow much of the \$60 billion a year they need just to pay interest on the debt.
- o As a result, the total LDC debt has increased by 43 percent to about \$850 billion.
- o For Brazil and Mexico debt has risen by almost \$24 billion in 3 years.

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- o Even among smaller countries debt has escalated since 1982--in the case of Panama increasing by 82 percent to over \$5 billion.

This unending debt buildup is lowering living standards and providing conditions that are ripe for unrest throughout the Third World.

- o Real wages in Latin America have fallen by 30 to 40 percent since 1982.
- o Key labor groups in countries like Mexico and Argentina have taken to the streets to protest austerity and repayment of the debt.
- o Austerity programs have led to riots in such countries as Morocco, Egypt, and Haiti.
- o In Nigeria, economic deterioration has contributed to two coups in two years.
- o In the Philippines debt related economic malaise is compounding political instability.

As Third World labor forces grow, investment grinds to a halt, and funds to import critical goods dry up, these problems will multiply. Given these pressures the debtor countries are drawing ever closer to the point where they face the option of revolution or debt repudiation. Obviously, neither option is good for us.

In many debtor countries today, we face essentially the same situation that we had in post-World War I Germany--debts can be serviced but only by significantly increasing the debt burden. The Dawes Plan was designed to reduce German war reparations payments in the short term so as to give the Germans time to

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increase their capacity to make full payment. The program, however, was too little too late. It got Germany through the early 1920s, but only because the Germans borrowed heavily from abroad.

- o For a five-year period, all annuities due--totaling 7.6 billion marks--were paid promptly and in full.
- o To do this, however, Germany borrowed over 14 billion marks abroad.
- o Export earnings during these years fell far short of the amount needed to finance debt payments.

Germany, in effect, borrowed from foreigners to pay its reparations, avoiding compression of domestic living standards as long as capital inflows continued. The Dawes and succeeding plans fell apart with the onset of the Depression.

While we are far from a depression now, the political pressures on leaders of debt-ridden countries are growing daily.

- o The Mexicans are facing growing pressures to take unilateral action that could lead to debt repudiation within the next few weeks.
- o If Mexico goes this route, it would be contagious with Argentina and Peru quickly following.
- o Outside Latin America we see many African countries as well as Asian countries like the Philippines getting on the band wagon.

To stop this potential groundswell, the US has to take the initiative.

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What we need is something like a Chapter 11 action on the Third World debt problem. One option--we think the best one--is a three-way split on eliminating principal. In this scenario industrial country governments would approve the write-off of one third of existing loans to troubled LDC debtors. International financial institutions--the IMF, the World Bank, and regional development banks--would assume responsibility for another one third of the debt. The debtor countries themselves would continue to be responsible for the remaining one third.

Such a plan would reduce the debt of the troubled debtors by two thirds and the interest burden would fall in parallel. Moreover, enough cushion would be created in the global financial system to allow a resumption of economic growth in debtor countries. By writing down the debt in this way, we would, in effect, be recognizing the reality that it will never be repaid.

The advantage of this option over current discussions on interest rates is that it deals with cause--principal--not the symptoms--interest payments. It also avoids the fundamental flaw in the Dawes Plan of being too little too late. More important, it puts the initiative in our hands rather than the debtors'. If the debt situation is going to unravel in any case, the US should be in the driver's seat.